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SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1931

No. 179

HERBERT S. DANIEL, TRUSTEE OF PETERS TRUST COMPANY, BANKRUPT, PETITIONER,

vs.

GUARANTY TRUST COMPANY OF NEW YORK, RESPONDENT.

REPLY BRIEF OF PETITIONER

HALLECK F. ROSE,
ARTHUR R. WELLS,
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Counsel for Petitioner.

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REPLY BRIEF

The corner stone of the respondent's position, as disclosed by its brief, is that the order of the referee, if affirmed, would wrongfully deny respondent of the right of a plenary action. If this right is not established, its whole argument must fall. The right to be heard in a plenary suit is based on two assumptions: (1) that it had an adverse claim to the funds in question and, (2) that as regards the $23,724.60 it was a mere debtor and therefore not subject to the summary jurisdiction of the court. Both of these positions are untenable.

It can not occupy the position of an adverse claimant for three reasons:

First. It asserted no adverse claim when the matter was before the referee. Its petition for reclamation (R., 1) made no mention of this fund. Paragraph 8 (R., 6) of Trustee's answer and the prayer (R., 7) sets out the claims of the bankrupt estate to these funds and prays for a summary turn-over order. The respondent moved to strike this portion of the answer "for the reason that this pertains to an entirely separate issue" (R., 8). The motion was not based on alleged adverse claim. After the motion was overruled the respondent filed a written dismissal (not found in the record) and as he was preparing to leave the room made the statement relied on by respondent (Br., 32-33). This was followed by the statement (R., 10): "The Guaranty Trust Company, by its attorneys, aren't interested in this proceeding. We do not believe we are in court, and we are not interested to stay." We submit such a statement of counsel is not a pleading and cannot be construed as an adverse claim. Both the referee (R., 22) and the Circuit Court (R., 40) found no adverse claim was asserted. It must be pleaded or it is waived. *Gamble* v. *Daniel*, 39 Fed. (2d) 447. The very filing of the reclamation proceedings negatives the suggestion that it was making a claim to these funds.

Second. The evidence fails to disclose an adverse claim in fact. The respondent took the assignment from the Guaranty Company after the bankrupt had been adjudicated insolvent and a liquidating agent had

assumed control (Respondent's Br., 2), all of which was then known to respondent (R., 16). The assignment could have been for no other purpose than to obtain an illegal preference and cannot be used as a set-off in bankruptcy. The respondent in several places refers to a "collateral pledge agreement" as giving it some lien on these funds. No such an agreement is found in the record and it is submitted that none exists. Furthermore such an agreement would be void under the bankruptcy laws if it applied to claims purchased in contemplation of bankruptcy. The respondent also states, on page 3 and other places, that it made a debit on the bankrupts "demand loan account" on November 27 for the amount of the assigned claim. The statement in evidence (R., 18-19) does not show such a debit. Hence respondent "paraphrased" the statement (Br., 46). The only purpose of this "paraphrasing" was to insert this debit, which was not in the statement as rendered. It is submitted no debit was in fact made until after it abandoned its reclamation action. The referee correctly found (R., 22) the respondent "has no claim to the said fund."

Third. The respondent made no complaint of the findings of fact of the referee in its petition for review (R., 23-24). The findings of fact are therefore conclusive. This is also true because the appeal to the Circuit Court was taken under Section 23*b* of the Bankruptcy Act, which takes the place of the former petition to revise. The respondent conceded it had no direct right of appeal and therefore presented its petition

to the Circuit Court for allowance. Under these proceedings only questions of law are considered. Therefore respondent is now precluded from asserting it had an adverse claim.

The respondent's second proposition is equally untenable. On the date of adjudication it held over $31,000 surplus collateral in the form of real estate mortgages. For this collateral it was accountable to the receiver and trustee of the bankrupt. At a later date it converted this collateral into cash. A fiduciary cannot thereby change its relation to a "simple debtor-creditor relation." It was still under a duty to account for this collateral, which duty is enforceable in a summary proceeding. The reasoning of this Court in *May* v. *Henderson*, 268 U. S. 111, is applicable here.

There is no merit in the respondent's suggestion (Br., 24) that because it had a right to collect the collateral and apply the proceeds on the bankrupt's loan it could comingle the funds so collected after this loan was satisfied. As soon as the loan was fully paid (Feb. 12, 1930) it was required to hold the balance for the petitioner. Furthermore, we see no reason why the funds thus collected should be treated different from any ordinary bank account. The respondent honored one check of the petitioner for $7,500 on this account and should have honored a check for the balance.

The petitioner frankly concedes that a simple debt, due the bankrupt before bankruptcy, can not be collected by a summary proceedings and therefore the collection of stockholders liability and similar cases cited by respondent are not in point.

To make it clear, we repeat the petitioner does not admit the respondent was entitled to have its rights determined in a plenary action but, on the contrary, contends that it was always subject to a summary proceeding; that by coming into the bankruptcy court in Nebraska it did not waive its right to a plenary hearing because it never had such a right, but merely submitted its person to the jurisdiction of that court. If the Nebraska court could not have obtained jurisdiction of the respondent, a summary ancillary proceedings could have been brought wherever the respondent could have been found.

The respondent in its Proposition I (Br., 10) urges that the referee had no jurisdiction to entertain the petitioner's counterclaim. This is based on two grounds: First, General Order XXXVII does not make Equity Rule 30 applicable to bankruptcy proceedings and, second, there is no binding precedent for such a counterclaim. The first theory is answered on pages 36 and following of petitioner's brief. We believe this is a "proceedings in equity, instituted for the purpose of carrying in effect the provisions of the Act," and thus controlled by General Order XXXVII. If this is not such a proceedings, what kind of a proceedings is it?

The respondent also argues (Br., 14) some of the equity rules are "impossible of application" in bankruptcy and therefore the General Order only referred to plenary suits to which the equity rules, by their inherent power, already apply. The rules that are "impossible of application" are not pointed out but, if

any such exist, full provision is made for them in the Order itself. The Order provides that the rules "shall be followed as nearly as may be" and further provide for certain modifications by the trial court.

On the second contention respondent cites no cases, holding that the referee has no jurisdiction to entertain a counterclaim when the counterclaim is within the jurisdiction of the referee as prescribed by the Bankruptcy Act. The cases referred to are all cases of recovery of fraudulent preferences or similar matters over which the referee is expressly denied jurisdiction.

We are not, therefore, asking for "a limitless extension of the power of a referee" as stated by respondent (Br., 17) but rather that the referee be allowed to exercise the power vested in him by the Bankruptcy Act. If upon personal service of the respondent within the territorial jurisdiction of the referee, the referee could not have made the order in question, he could not do so on the counterclaim of the petitioner. No sufficient reason is suggested why the reverse of this is not also true.

The respondent has not correctly analyzed the cases cited by petitioner on pages 50 to 56 of his brief. The respondent (Br., 21) states the petition In re Pennsylvania Coffee Co. "was filed as a *plenary* suit." This is not true. The court in the opinion expressly held a plenary suit was not necessary. In re Barnett the referee on the trustee's counterclaim summarily ordered the petitioner to turn over the proceeds of the bankrupt's bonds which it held. It did not merely

refuse to allow a claim as stated by respondent (Br., 22). The counterclaim was used as a sword, not merely a shield. We believe that some of these cases are precedents for the petitioner's position but if there are no precedents and this is virgin soil, the rule announced in the cases cited by petitioner (Br., 50-56) is fundamentally sound and should be established by such a holding of this court.

The respondent admits (Br., 18) that if in the reclamation proceedings the referee had found the bonds should be delivered to the respondent, the order could have properly been conditioned upon the respondent surrendering the funds in question. It was therefore necessary for the Trustee (now petitioner) to plead the facts set out in paragraph 8 of his answer. Consequently, the allegations are germane and the referee did not error in refusing to strike this part of the answer.

The last contention of the respondent that the order of the referee, affirmed by, and also made the order of the District Court, was in effect a money judgment, is without merit. Both the referee and the District Court was fully aware of its limitation in this respect and only entered a turnover order. Whenever the subject of a turnover order is money, the practical effect of the order may be similar to a money judgment but this does not make it a money judgment or transgress the limitation on the power of the referee.

The last point to be noted is the respondent's plea that on an order of reversal it should be given the privilege of reopening the entire case. Equity does not

require the granting of such a privilege. The respondent tried to obtain a favored position. It was not satisfied to come in and share with the other creditors. The Trustee is guilty of no sharp practice but only fulfilled his duty in opposing the respondent's attempt to obtain an illegal preference. The Trustee went further and pointed out that a claim should be filed (R., 6). The respondent had from April 25 to June 10 to file such a claim after the referee's order was entered. It is therefore submitted there is no reason for granting the respondent's unusual request. Whether a claim may still be filed under Section 57*n* is not before this court, so need not be considered here.

In conclusion, the petitioner prays that the holding of the Circuit Court be reversed and the turnover order of the referee be affirmed.

Respectfully submitted,

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